Institute for Fiscal Studies

Higher Education Funding: more change to come?

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Executive summary

This Election Briefing Note provides a summary of the current higher education funding system in England and investigates the two big reform packages that are currently on the table going into the 2019 General Election. The main takeaways are:

- The up-front cost of teaching each cohort of undergraduate students is around £17bn. Most of that money is given out in student loans, which students repay on an income-contingent basis, paying 9% of their income above a certain threshold (currently £25,725). Once graduate loan repayments are accounted for, the cost of providing higher education is roughly evenly split between the government and students, due to the high write-offs on student loans (currently around 45% is expected to be written off). Less than one-fifth of graduates are forecast to repay their student loans in full.

- In 2018, the government increased the repayment threshold from £21,000 to £25,000 and froze fees in cash terms at £9,250 per year. Combined, this has dramatically reduced the contribution to higher education from graduates, with middle earning graduates set to benefit the most. The impact for government is a substantial increase in the subsidy to HE by around £1.5bn for the 2020 cohort. Universities have experienced a cut in per-student funding, which is set to reach £1800 per degree for the 2020 cohort.

- The Labour Party have proposed to abolish fees altogether and to bring back maintenance grants for students from poorer households, which were abolished by the previous government in 2016. Both policies reduce students' notional debt on graduation but do not affect the cash support they receive from government during study.

- Combined, these policies would increase the long-run taxpayer subsidy by around £6.5bn per year for full-time undergraduate students, assuming student numbers stay at their current levels. The cost of abolishing fees is around £1.5bn lower now than we estimated in 2017, mainly because the increase in the repayment threshold means the taxpayer is already contributing more towards the cost of the system.

- The highest-earning graduates would benefit the most from Labour's policy, with loan repayments of the top third being reduced by around £50,000. Low earning graduates would graduate with lower notional debt levels but would be almost completely unaffected in terms of actual loan repayments.

- Labour would also extend maintenance support to all part-time students studying for standard undergraduate degrees. Furthermore, its policy of scrapping tuition fees and reintroducing maintenance grants would apply to part-time students and students of higher education qualifications below degree level. Assuming unchanged student numbers, this would add around £500m to the government subsidy for part-time students doing standard undergraduate degrees and another £500m for students pursuing higher education below degree level (or more if Labour decided to extend eligibility beyond those currently eligible for tuition loans).

- These estimates of the cost of the policy are likely to be conservative, as the combination of completely free tuition with the current policy of having no cap on student numbers could see student numbers rise further. Bringing back student numbers caps, which were recently removed, could mitigate this problem, but this would likely harm access to university for poorer students.

- Under Labour's plans to support lifelong learning announced last week, free tuition, and maintenance grants and loans, would be available not only for an initial qualification, but for a period of six years, to be used at any point in life for any qualification up to a standard undergraduate degree (or equivalent). This would increase the educational opportunities of those who have already obtained a qualification but could lead to a substantial further increase in the taxpayer cost of the higher education funding system and, depending on the details of the policy, increase the risk of fraud.

- There are several uncertainties with Labour's stated policy. Most pertinently, there is the issue of outstanding student debt, which the Labour Party has previously suggested it would "deal with". Even if only tuition fee debt of post-2012 cohorts would be written off, this would cost around £20bn.

- The Augar Review – another major reform package potentially on the table - proposed to cut the cap on tuition fees to £7,500, replacing most of the income lost to universities with teaching grants focussed on high cost/high value subjects like engineering. This recommendation was intended to help the government to direct subsidies to where they might be most beneficial economically, rather than to courses where earnings after graduation are lowest as is the case at present.

- The Augar Review also proposed to cut loan interest during study and add a cap on the total loan repayments any individual could make. To balance costs, the loan repayment threshold would be reduced again to around £23,000 and the repayment period extended from 30 to 40 years.

- Broadly speaking the Augar proposals would reduce repayments from higher earning graduates and increase them over the lifetime of lower and middle earning graduates. But the magnitude of these latter increases would be no more than a reversal of the impact of the increase in the repayment threshold implemented by the current government.

- The Brexit Party has promised to axe interest rates on student loans altogether. This would cost about £3.5bn, increasing the government contribution to higher education by more than 40%. Again, the highest-earning graduates would benefit the most.

- The Liberal Democrats have been fairly quiet on higher education funding, but have proposed a £10,000 "adult education grant" which would provide more funding for older learners to re-train. This is similar to Labour's "six-years free" policy but substantially less generous and only kicks in at age 25, unlike Labour's policy which has no age restrictions. The cost of this scheme, and the risk of fraud, will crucially depend on how tightly it is regulated.

- The Green Party's policy on higher education funding is similar to Labour's. However, in contrast to Labour, the Green party explicitly advocates the cancellation of *all* outstanding student debt. This would come at a one-time cost of £70 billion.

1. Introduction

Under the current higher education (HE) funding system in England, it costs around £17 billion to fund the education of each cohort of full-time undergraduate students. This includes the cost of teaching for three or more years and funding towards the cost of living while at university for more than 350,000 students each year. Initially, this cost is funded largely by the government. In the long run, however, graduates make repayments on their student loans and consequently the cost is split roughly evenly between taxpayers and students.

The HE system is funded primarily through tuition fees, with almost all universities charging the maximum fee of £9,250. A much smaller share of university funding comes through government teaching grants. Most students can take out government-backed loans to cover the full cost of tuition fees and a large fraction of living costs. These loans are repaid on an income-contingent basis: graduates repay 9 percent of their income over a threshold of £25,725 and any outstanding loan is written off at the end of the repayment period of 30 years.

This system ensures that students do not face a high up-front cost of HE. It also provides insurance for graduates, as people who fall ill, take time out to care for their families or simply do not manage to secure a well-paid job do not have to make repayments on their loans, and experience no penalty for having debt written off at the end of the repayment period. Without this insurance, people might be put off from going to university due to the risk of being burdened with unaffordable loan repayments, although it of course adds to the long run cost of the system to the taxpayer.

As a result of this design, the system is very “progressive” in the sense that high-earning graduates go on to pay far more for their degrees than low earning graduates. This is highlighted in Figure 1, below, which shows that the highest-earning 10% of graduates pay around £80,000 towards the cost of their degrees (in current prices, non-discounted terms), while the lowest-earning 10% of graduates repay almost nothing. Less than one-fifth of graduates are forecast to fully repay their loans before the end of the repayment term. This progressivity comes at a high cost to government, as the overpayments of the highest earners do not compensate for the underpayments of the lower earners. The government therefore expects to write off a bit less than half (45%) of the total loans it issues.

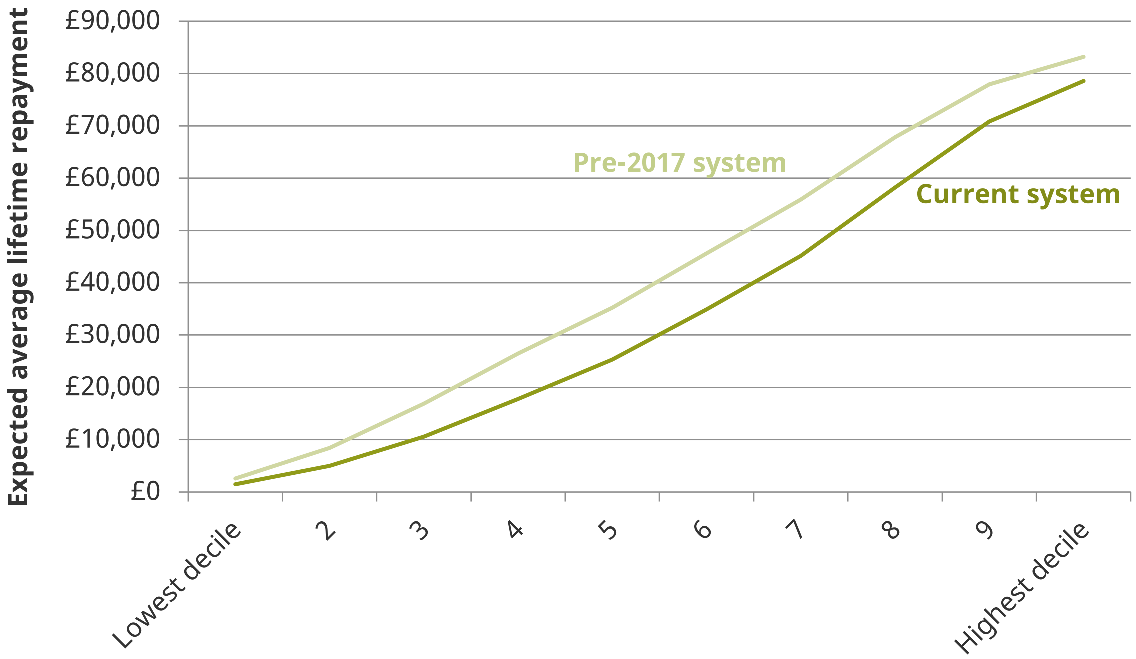
In this Election Briefing Note, we start by documenting the main changes that have been made to the system since the 2015 general election. We focus on two changes announced by the current government, namely a freeze in tuition fees and an increase in the repayment threshold on student loans that were announced in October 2017. Following this, we consider some of the important critiques of the current system before turning to some of the proposals to reform it. We focus in particular detail on the Labour Party’s plan to abolish tuition fees, as well as the proposals outlined in the recent Augar Review of Post-18 education. We also discuss the proposals of the Brexit Party, the Liberal Democrats and the Green Party.

2. Recent changes

We start by considering some of the changes to the system implemented since the large tuition fee reforms in 2012. While the broad outline of the current system has not changed since then, some important details have. Following changes announced in the Summer Budget of 2015, the repayment threshold was frozen at £21,000 (instead of increasing in line with average earnings). Maintenance grants for students from low-income backgrounds were replaced by additional maintenance loans in 2016. In late 2017 the current government announced a freeze in fees at £9,250, as well as an increase in the repayment threshold to £25,000. The threshold was also once again linked to earnings growth, resulting in a repayment threshold of £25,725 today. This increase more than reversed the impact of the threshold freeze that had started just the year before and had been intended to go on until 2021.

The cash terms freeze of tuition fees reduced notional debt on graduation for students initially by a very small amount: those starting a three-year degree in 2017 and taking out their full loan entitlement experienced an average debt reduction of around £800 (less than 2%). This had no impact on the compulsory loan repayments of the vast majority of borrowers. For the government, this policy initially saved around £0.3bn in the expected subsidy for the 2017 cohort of students. Both the reduction in expected debt on graduation and the savings for the government are set to grow for subsequent cohorts, as fees would have risen with inflation without the freeze.

Figure 1: Expected average lifetime repayments by decile of graduate lifetime income for 2020–21 cohort (2019 prices, not discounted)



Note: Figures in 2019 prices, deflated using CPI inflation, not discounted. These figures apply to England-domiciled students starting at a UK university in 2020–21. We assume that all borrowers take out the full loans to which they are entitled, that there is no dropout from university, that graduates repay according to the repayment schedule and that they have low unearned income.

Source: Authors' calculations using IFS's graduate repayments model.

For universities, the freeze has reduced funding per student in real terms. As with government spending, while the impact is small in the short run, it will grow as long as the freeze is kept in place, which creates uncertainty. However, one important caveat to this is that due to the removal of student number controls between 2012 and 2015, universities are now able to respond to this funding cut by expanding their student bodies. This may enable them to exploit economies of scale in the provision of teaching, but may also reduce cost savings for the government.

The increase in the repayment threshold has already had a much larger impact on both graduate repayments and the government cost of providing HE. All graduates with non-negligible outstanding debt and incomes above £25,725 now pay £425 less per year (9% of £4,725 – the difference between the old and new repayment thresholds). Figure 1 shows the impact of the combination of these two policies on the lifetime repayments of graduates in the 2020 cohort. Virtually all graduates are better off as a result of the changes announced in 2017: the highest-earning graduates benefit mostly from the cut in fees, while middle and lower earning graduates benefit from the reduction in the repayment threshold, by up to around £10,000 over the course of their lifetimes.

Because it has led to lower graduate repayments, the increase in the repayment threshold has significantly increased the overall cost of higher education for the government. The proportion of total loans the government expects to write off, the "RAB charge", is now around 45% and thus around 10 percentage points higher than it would have been under the lower threshold and without the freeze in fees. Overall, the reforms the government announced in 2017 have added around £1.4bn to the yearly government subsidy to undergraduate degrees, an increase of more than 20 percent.

3. Downsides of the current system

There are several highly desirable features of the current HE funding system. Primarily, it appears that the availability of student loans and the generous insurance embedded within them has prevented large increases in fees from feeding through into reduced participation among full-time students, in particular for students coming from poorer households. Nevertheless, the current system has been much criticized in recent years.

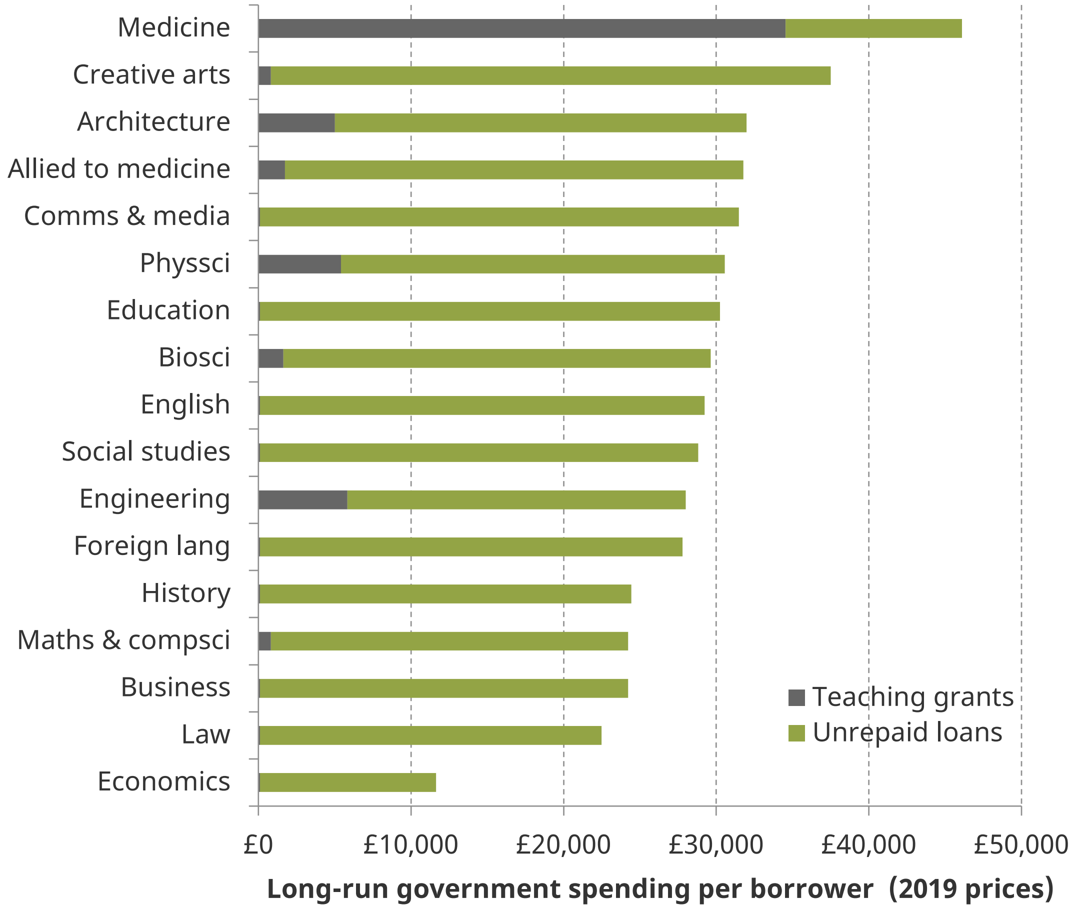
One reason for this is the high cost of the system for the taxpayer, which has recently come into increased scrutiny following a change in the way student loans are treated in the government accounts. Among other changes, the ONS now counts *expected* losses on student loans towards the deficit when the loans are made, whereas previously losses on student loans were only counted *at the end of the loan term* if loans were retained on the government books, or *never at all* if they had been sold on to private investors.

In total, this change in accounting has increased the deficit by around £12 billion in 2018–19, rising to £17 billion in 2023–24. This is more than the expected long-run cost of the government subsidy for each cohort because of the rather baffling way interest was previously accounted for. Under the old system, not only were expected losses on student loans not counted, but all accrued interest on student loans was counted as income for the government, even though in practice almost none of it would ever be paid. Thus, the student loan system as a whole was previously treated as a source of income in the government budget (at least in the short term), even though in reality it is a significant expense. Due to the removal of this fiscal illusion, moving to the new treatment appears more costly than the true cost of the student loan system to the government.

Besides high cost, another feature of the current system that has been criticized is the government's lack of control over the allocation of the taxpayer subsidy to HE. Around 90% of the government subsidy now comes through unrepaid loans; as students are eligible for the same loans for all subjects and at any university, individual students and not the government effectively decide where funding is allocated.

Per-student government spending on a given course mostly depends on the earnings of its graduates. Overall, the courses with the lowest earning graduates are subsidized the most, and those with the highest-earning graduates are subsidized the least. The reason is that lower earners pay back a smaller fraction of their student loans, and there is little variation in the annual fee and maintenance loans per student across different courses.

Figure 2: Total long-run government spending by subject



Note: Taken from Britton et al (2019) "Where is the money going? Estimating government spending on different university degrees". Figure uprated to 2019 prices. Only a subset of subjects are shown.

Source: Calculations based on HMRC administrative data sets.

The variation in implicit government spending per borrower across subject studied is outlined in Figure 2 (taken from IFS research published earlier this year). Students who study economics – one of the highest-earning subjects – receive around £11,000 in government subsidy towards their degrees on average, while students who study creative arts – one of the lowest earning subjects – receive more than £35,000 in government subsidy, despite little difference in grants or course length.[1] This allocation is unlikely to align with the government's priorities.

[1] Medical students actually receive very large subsidies of around £45,000 per degree despite generally going on to have very high earnings due to the very high cost of provision of medical degrees and hence the large teaching grants associated with them (as well as longer course length).

Furthermore, as a consequence of the limited differentiation in the funding universities receive across subjects, STEM subjects, which are relatively expensive to teach, appear to be loss-making for universities, while subjects that are less expensive to teach are overfunded.[2] This situation has created incentives for universities to expand provision predominantly in subjects that are relatively inexpensive to teach, many of which are low earning arts and humanities courses.[3] Due to the high implicit government subsidy, increases in student numbers on these courses are especially costly for the government.

4. Major reform proposals

Two major reform packages have recently been proposed to address some of the perceived flaws in the system we have outlined above. The first is the Labour Party's proposed reform package that is built around a commitment to scrap tuition fees. The second is the set of reforms proposed by the Augar Review, a comprehensive independent review of the post-18 education system.

The **Labour Party** has pledged to abolish tuition fees altogether replacing the lost fee income for universities by increasing teaching grants. It would also reintroduce maintenance grants for students from low income households, reversing the 2016 government policy which converted maintenance grants of up to around £3,500 per year into additional loans for the poorest students. Both of these proposals would reduce students' debt on graduation, but leave their cash support for maintenance during study unaffected.

Further details on the Labour Party's education policy were released last week as part of a policy initiative to support lifelong learning. Two announcements are relevant for HE funding. First, both free tuition and the reintroduction of maintenance grants would not only apply to those pursuing standard undergraduate degrees, but also to students on HE courses below degree level. Second, both policies would not only apply for one qualification, but for up to six full-time equivalent years of study at any point in life.

The **Augar Review** proposed several changes to the HE system. The most notable was the recommendation to reduce the headline tuition fee cap to £7,500. The lost fee income would mostly be made up with increased direct grants to universities (following a nominal freeze in teaching grants plus tuition fees until 2021), which would allow the government greater flexibility in targeting spending.

In addition, the Augar Review proposed a reduction in interest charged *during study* from RPI + 3% to RPI + 0%, as well as a cap to repayments so that no graduate would ever repay more than 1.2 times the real value their original loan. In order to achieve revenue-neutrality, the review further proposed to extend the repayment period from 30 to 40 years, and to reduce the repayment threshold to the median of non-graduate earnings, around £23,000.

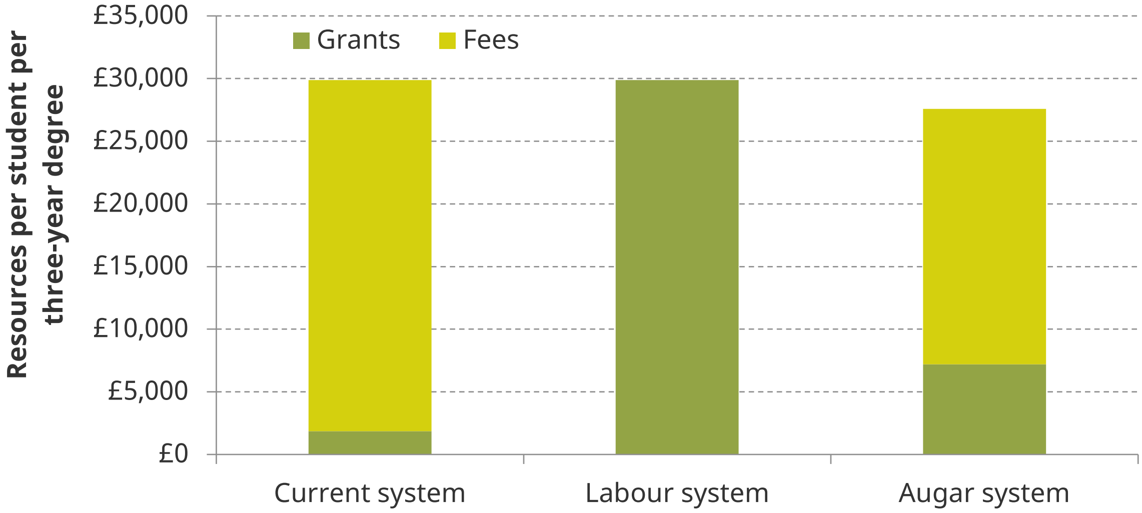
As shown in Figure 3, both the Labour Party proposal and the Augar Review plan would shift university funding for undergraduate teaching away from fee income and towards direct grants. However, the Labour Party's plans are much more radical: while

[2] See KPMG report on the costs of undergraduate provision: link.

[3] While big shifts in student numbers towards these degrees have not been observed so far, there is some evidence that universities have relaxed their entry standards for such degrees in order to keep up student numbers in spite of reductions in demand, as highlighted in Britton, Farquharson and Sibieta (2019).

the Augar Review proposals would only replace a relatively small share of funding from student fees by grants, the Labour proposal would replace it entirely. Total university funding would in principle stay constant under the Labour Party's proposals and fall slightly under the Augar plan in the coming years as a result of the proposed nominal freeze in fees and grants.

Figure 3: University resources per student per degree, 2022–23 cohort (2019 prices)



Note: 2019 prices. Includes full-time-equivalent three-year degrees only. University resources exclude any maintenance support and funding from targeted allocations.

Source: Authors' calculations based on projected teaching grants and tuition fees for 2022–23.

5. Impact of the Labour Party's proposals

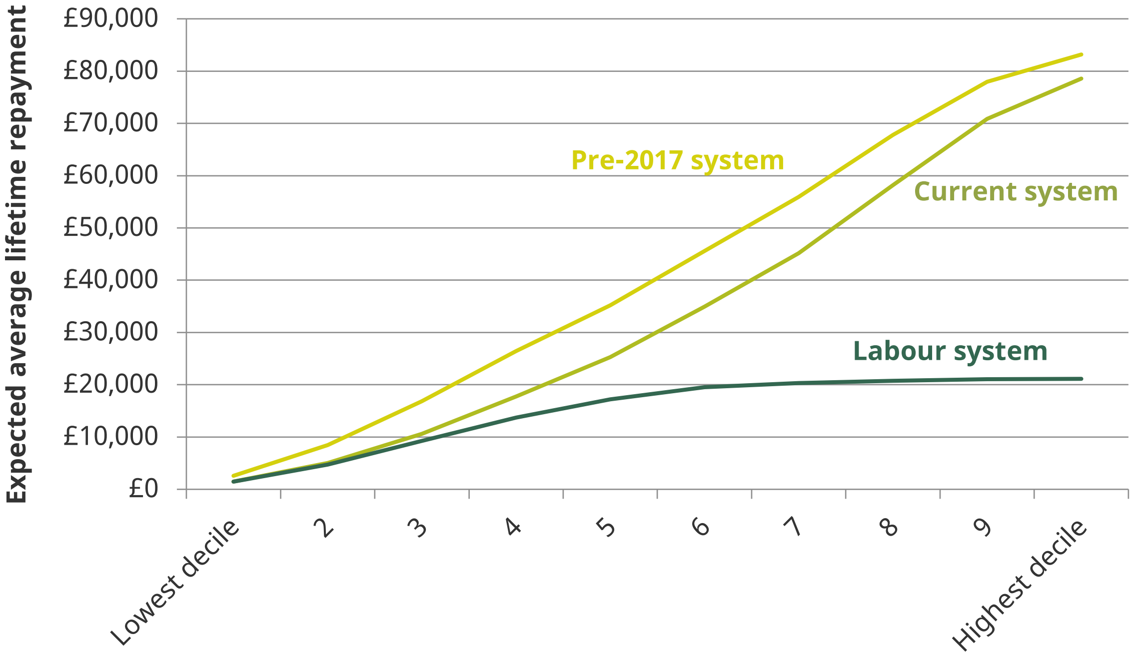
5.1 Cost of the policy and distributional effects

We estimate that abolishing fees alone would add around £5bn per year to the government subsidy of standard undergraduate degrees, assuming student numbers are unchanged and tuition fees are replaced one-for-one by teaching grants, holding total university funding fixed. Most of this cost would come from a reduction in the loan repayments of borrowers, although around 20% of it would replace the fees paid by individuals (presumably from relatively wealthy backgrounds) who would not have taken up loans under the current system.

Bringing back maintenance grants for the poorest students of up to around £3,500 per year, a similar level to before they were scrapped in 2016, on top of scrapping tuition fees would come at an additional cost of nearly £1.5bn, driven by a reduction in student loan repayments. Overall, we would expect Labour's proposals on tuition fees and maintenance grants to bring the government cost of sending a cohort of full-time, first degree undergraduate students through HE to around £14.5bn, an increase of around £6.5bn. As the 2017 reforms substantially increased the government subsidy to HE, Labour's policy is now around £1.5bn cheaper than the equivalent figure we estimated in build-up to the 2017 General Election.[4]

[4] This is a comparison of the *long-run* cost of the system. In 2017, it was also noted that scrapping fees would add substantially more to the deficit (around £11bn in total). This headline number was based on the old accounting treatment of student loans. The deficit impact of Labour's reforms is now smaller as the new accounting treatment takes into account losses on the loans today. There is a nuance to this issue in that the

Figure 4: Expected average lifetime repayments by decile of graduate lifetime income for 2020–21 cohort (2019 prices, not discounted)



Note: Figures in 2019 prices, deflated using CPI inflation, not discounted. These figures apply to (projected) England-domiciled students starting at a UK university in 2020–21. We assume that all borrowers take out the full loans to which they are entitled, that there is no dropout from university, that graduates repay according to the repayment schedule and that they have low unearned income.

Source: Authors' calculations using IFS's graduate repayments model.

The reduction in graduate repayments from this policy would not be equally spread across graduates. Figure 4 shows average graduate repayments under the current system and the system proposed by the Labour Party by decile of graduate lifetime earnings. Under the current system, the highest-earning graduates contribute significantly more towards the cost of their degree than lower earning graduates. Repayments under the Labour proposal would be much less progressive, and the highest-earning graduates would gain by far the most from the proposed changes. The lowest earning third of graduates would only gain around £500 over their lifetimes, while repayments of the richest third would go down by nearly £50,000.

Labour's plans for part-time students and students of non-standard undergraduate level courses will roughly add another £1bn to the cost of the plans. Abolishing fees for part-time students of standard undergraduate degrees would cost around £300 million. Extending maintenance loan and grant eligibility for this group would cost the government another £200 million. Scrapping fees for all students on HE courses below degree level would add another £500 million. This brings the total cost of the policy to around £7.5bn.

Labour's announcements this week promising free higher education for each individual for six years rather than only for a first qualification will further add to the overall costings above. Precisely how expensive this would be will depend on the details of the policy. What is clear is that it would give millions of people the opportunity of gaining an

losses do not count towards the *current account deficit.* For a more detailed discussion of this, and deficit impacts more generally, see Britton, Farquharson and Sibieta, 2019 (Ch. 5 Higher Education): link.

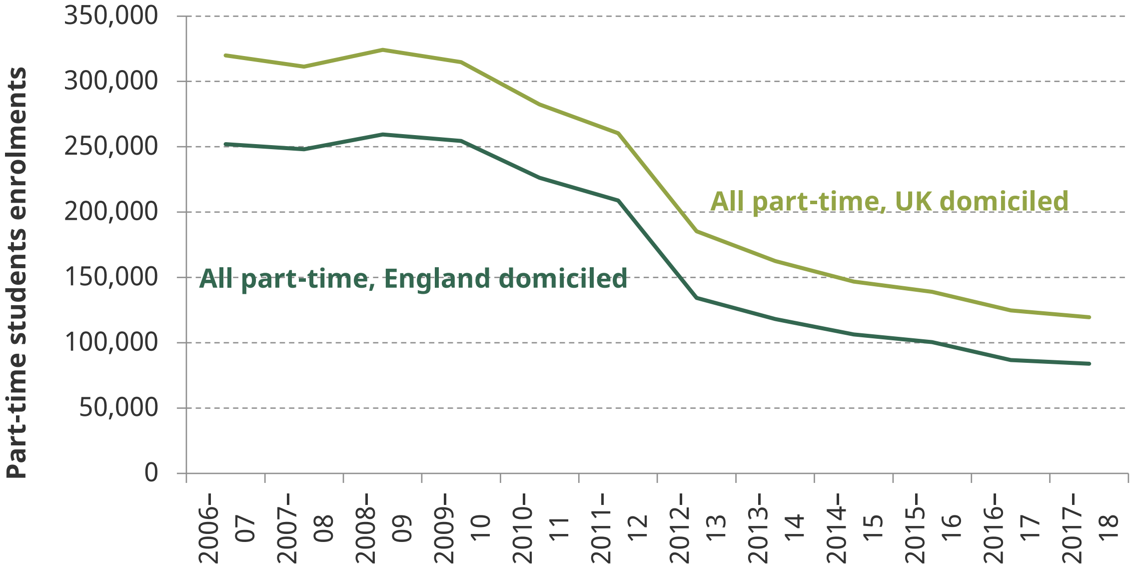
additional qualification at no cost; it seems reasonable to assume that tens of thousands might make use of it. While this *may* help some of these people to gain higher wages in the long run, depending on how tightly the system is regulated, it could cost billions of pounds for the government.

5.2 Further considerations

The above costings rely on some very strong assumptions: we assume no changes in student numbers, in the composition of students, in the distribution of their choices, or in their lifetime earnings. In practice, these assumptions are unlikely to hold. In particular, when university education is free, in the absence of a student number cap it is very possible that we would experience large growth in student numbers.

Over the past 10 years full-time student numbers have been fairly stable. However, as Figure 5 shows, those of part-time students have plummeted since 2009, when loan availability for part-time students was significantly reduced. The large increase in tuition fees in 2012 also appears to have contributed to this fall. This decrease in student numbers in response to lower loan availability and higher fees suggests that abolishing tuition fees and extending loan availability would result in a potentially substantial increase in demand from part-time students. Although recent evidence makes it harder to predict the impact for full-time students, it seems reasonable to assume that higher education is an "ordinary good", so that lowering its price would increase demand, in particular from mature students who currently face more limited access to student loans.

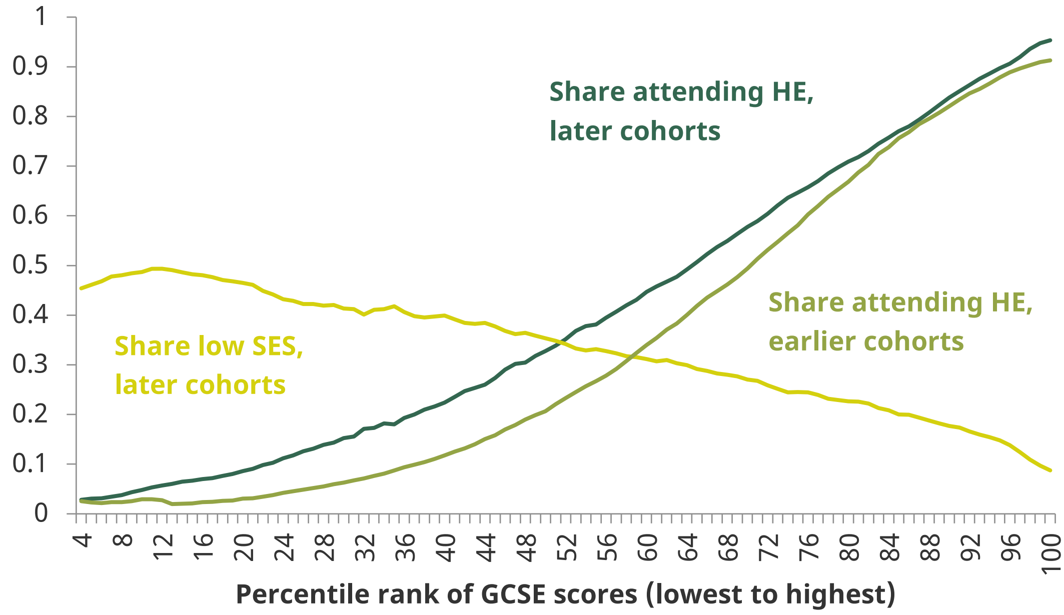
Figure 5: Part-time student numbers at UK institutions



Source: HESA. Includes first year enrolments for people student "Other" and "First" undergraduate degrees.

Student number growth would of course add to the costs of abolishing fees. These higher costs may eventually be offset by increased tax receipts due to the higher earnings of the additional students achieved through attending HE. However, caution should be exercised here, as any growth in HE participation is likely to come from students with lower GCSE and A-level grades than the average for university students. We see an indication of this in Figure 6, which shows the share of people going to HE by GCSE attainment, comparing people who took their GCSEs in the early-mid 2000s with people taking their GCSEs in the late 2000s. Much of the expansion in HE during this period was amongst those with lower GCSE scores than the average of earlier cohorts attending university. As most students near the top of the GCSE score distribution already attend university under the current system, the same is likely to be true for any further expansion.[5]

Figure 6: Share attending HE and from low SES backgrounds by GCSE scores



Note: earlier cohorts took GCSEs in 2002-2004; later cohorts in 2008-2010. Low SES is based on being in the bottom third of our SES index, which is based on local area measures of deprivation from the NPD.

Source: author's calculations from NPD-HESA data

Figure 7, adapted from our recent report on the returns to undergraduate degrees[6], shows that individuals with lower prior attainment are likely to go on to earn less than those with higher prior attainment, and see less of an earnings boost from HE, especially true for men. The university education of additional students is therefore likely to be particularly costly for the government, as these students will earn less and hence make lower student loan repayments than current students.

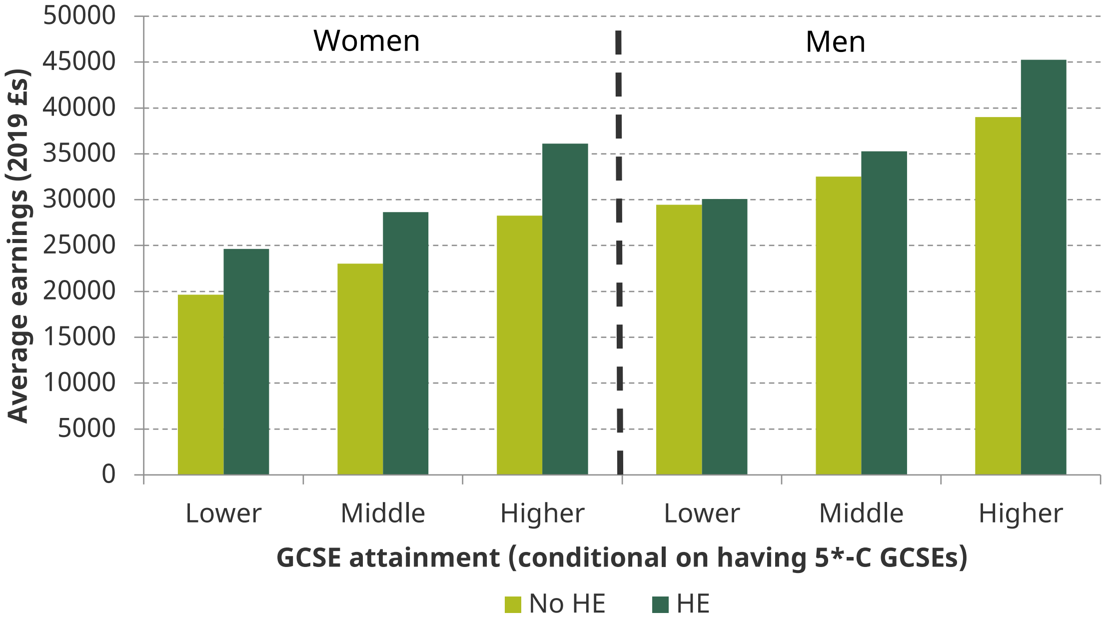
If a Labour government wanted to prevent growth in enrolment among those with low prior attainment, one option would be to reintroduce student number caps. This, however, introduces a different issue, as those with low prior attainment under the current system are more likely to come from poorer households (as shown in Figure 6 above). Unless there is a robust system in place to contextualise offers, a cap on student numbers could therefore mean that many students from lower income families would not be able to access higher education. More generally, any binding cap in student numbers would by nature directly exclude some students from higher education (generally or in a particular subject) who would have liked to attend. This is

[5] However, economic theory would predict that because those with high GCSE scores are more likely to be higher earners later in life, and high earners would benefit disproportionally from Labour's policy, the additional enrolment as a result of Labour's policy would comprise more students with high GCSE scores than previous expansions.

[6] See Belfield et al (2018) "The impact of undergraduate degrees on early career earnings".

qualitatively different from the current system, where all students are in principle free to attend so long as they can find a university that will accept them.

Figure 7: Average earnings at age 29 by prior attainment, HE status and gender



Note: Taken from Belfield et al (2018) “The impact of undergraduate degrees on early-career earnings”, in 2019 prices

Source: LEO data (NPD-HESA-HMRC).

5.3 Some clarification required

Beyond the issue of how a Labour government would manage student demand, several details remain unclear about Labour’s plans. Here we focus on five outstanding issues.

First, Labour has not fully spelled out the mechanics of the six-year cap in support so far: how part-time degrees would be counted, which qualifications exactly would be eligible, or how the policy would interact with the free fees policy for standard undergraduate degrees. Labour also has not announced what support, if any, would be available to students after the six-year budget was used up. All of these choices have potentially substantial consequences both for the cost of the policy and for whether the policy could really achieve its goal of supporting retraining e.g. for those who might initially have done a four-year undergraduate degree.

Second, Labour has not said what support would be available for those studying for qualifications that are not currently eligible for loans. Currently, there are around 100,000 students enrolled on non-eligible courses, which include professional training such as post-registration nursing qualifications. While Labour’s commitment to lifelong learning might seem to imply that these courses should be fully funded as well, this would further increase the taxpayer cost of the proposals.

Third, Labour has not announced what safeguards it would put in place to prevent abuse of the system. This would be an especially important concern if eligibility requirements for free fees and maintenance grants would be less strict than current student loan eligibility criteria. The ill-fated Individual Learning Accounts scheme introduced by the Blair government offers an example of what can happen when eligibility criteria are lax and regulation is inadequate. The programme, which offered government subsidies for a wide range of adult education courses, was scrapped completely in 2001 after just one year of operation due to widespread fraud.[7]

Fourth, it is not clear how non-English students in England and English students in the devolved nations would be treated under Labour's proposal. If free fees only applied to English students in England, in the same way that the Scottish government offers free education in Scotland only for Scottish students, English students would have a strong incentive to study in England (just as Scottish students already have a strong incentive to study in Scotland). If the Welsh and Northern Irish administrations decided to follow suit and abolish student fees, the same would apply to students from Wales and Northern Ireland. This would be an unfortunate outcome: students should be able to attend the courses that are most suitable for them, and not only the ones that happen to be offered within their home nation. A reciprocal agreement would seem desirable.

Fifth, Labour does not indicate in its proposals what would happen to outstanding student loans. Jeremy Corbyn, the Labour leader, has previously appeared to suggest that all post-2012 tuition fee debt would be cancelled under a Labour government.[8] This could add around £20bn[9] to the national debt in the long run, and will mostly benefit graduates since 2012 who still have high outstanding debt and are set to have high earnings in the future.

6. Impact of the Augar Review proposals

The primary intention of the Augar proposals on HE was to address some of the issues associated with incentives in the system and with the distribution of government spending on HE. Here we focus on the overall impact of the policy recommendations in terms of costs and the mechanical effects on graduates before considering its individual components in more detail and how they relate to Augar's objectives. Although in practice the review proposed that the system would not be fully implemented until 2022, here we produce estimates for the 2020 cohort here for more direct comparability with the other reform proposals.

6.1 Cost of the policy and distributional effects

We estimate that implementing the package of reforms to the HE funding system proposed by the Augar review is roughly revenue-neutral for the government, but that it comes with significant distributional impacts. Figure 8 highlights these, showing that highest earning 10% of graduates would see reductions in their lifetime repayments by up to £30,000, while some middle and lower earning graduates would see large increases in their lifetime repayments of more than £10,000. This is a considerable increase, but it is notable that this would simply return the lifetime repayments of middle and lower earning graduates to very similar levels to where they would have

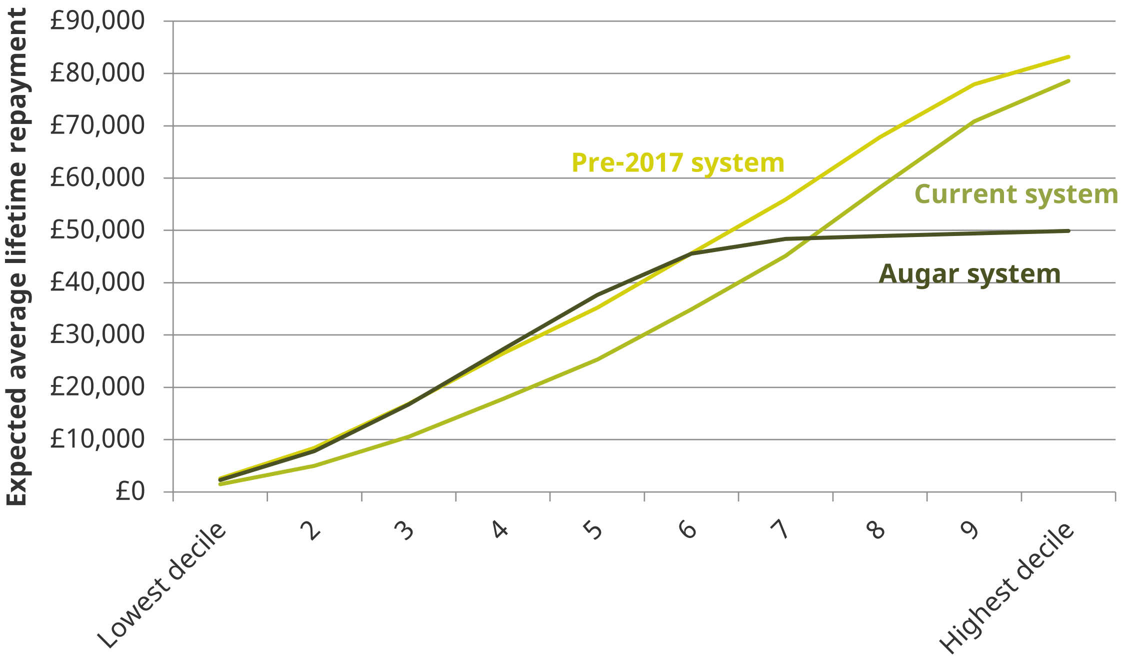
[7] Details can be found in this report by the National Audit Office.

[8] See link

[9] This is lower than implied by our estimate in September 2017 (see here) due to the increase of the student loan repayment threshold which was subsequently introduced by the government. This increase in the threshold led to a lower fraction of debt being paid off, and hence a lower cost of scrapping the debt.

been had the current government not substantially increased the repayment threshold in 2017, as shown in Figure 8.

Figure 8: Expected average lifetime repayments by decile of graduate lifetime income for 2020–21 cohort (2019 prices, not discounted)



Note: Figures in 2019 prices, deflated using CPI inflation, not discounted. These figures apply to (projected) England-domiciled students starting at a UK university in 2020–21. We assume that all borrowers take out the full loans to which they are entitled, that there is no dropout from university, that graduates repay according to the repayment schedule and that they have low unearned income.

Source: Authors' calculations using IFS's graduate repayments model.

6.2 Fee reduction to £7,500

The proposal in the Augar Review that received the most media attention was a cut in maximum tuition fees to £7,500. The Review gives two separate justifications for this proposal. First, it argues that current fee levels of £9,250 are unreasonably high for the courses that are the least expensive for universities to teach. Second, it claims that the reduction would go some way in counteracting the effect of debt aversion: especially students from lower-income backgrounds might be less discouraged from going to university if they had to incur a smaller amount of (notional) debt.

As discussed above, there is indeed good reason to think that the current system has created incentives for universities to expand provision in subjects that are relatively cheap to teach, which may not be socially optimal. The benefit of reducing the fee cap to £7,500 on this score would be that the government could bring about higher differentiation of funding levels through the teaching grant system without significant increases in overall cost. Under the Augar proposals, the subjects that are cheapest to teach would receive no additional teaching grants, reducing funding per student for these courses by up to almost 20%. For STEM subjects on the other hand, the reduction in fees could be more than counterbalanced by an increase in teaching grants, increasing overall funding levels for these subjects.

Augar's second justification for the fee cut relies on a wholly different argument, namely that it would reduce the overall level of debt that students take on, which might encourage more students from low income backgrounds to apply. While under the current system students face limited upfront costs and receive generous insurance from the income contingent loan system, misconceptions about the system remain widespread. In particular, notional loan balances of more than £50,000 as well as the high interest rate charges may put some students off from going to university, even though in practice the vast majority of them will never have to repay these large loans. However, it is unclear whether a fee cut of this magnitude will indeed have the desired effect of increasing participation of students from lower income households.

6.3 Interest rate changes

A second set of proposals in the Augar Review that has attracted less attention relates to the interest rates on student loans. Under the current system, students are charged an interest rate that equals the Retail Price Index (RPI) + 3% while they are pursuing their degrees. After students leave university, the rate varies from RPI + 0% for low earners to RPI + 3% for high earners. These rates far exceed the government's cost of borrowing: for long-term borrowing, the government currently pays an interest rate of around RPI minus 1.5%[10] (which is very low by historical standards). This means that on the outstanding loans of high-earning graduates who are charged the interest rate of RPI + 3% throughout and who will pay off the full student loan including interest, the government currently makes a substantial profit of up to around 4.5%.

The Augar Review proposes that the interest rate charged while students are still studying should be RPI + 0%, as opposed to RPI + 3% under the current system. The interest rate charged after students leave university would remain unchanged, although a new repayment cap of 1.2 times the real value of the original loan would be introduced, above which no repayments would have to be made.

These proposals would go some way towards closing the gap between the government's cost of borrowing and the interest rate charged to students. Scrapping the unpopular surcharge over RPI while students are at university is certainly welcome. However, as the government's current cost of funding is below RPI, any student hitting the repayment cap of 1.2 times the original loan value would still be paying significantly more than the current cost to the government of financing their loan.

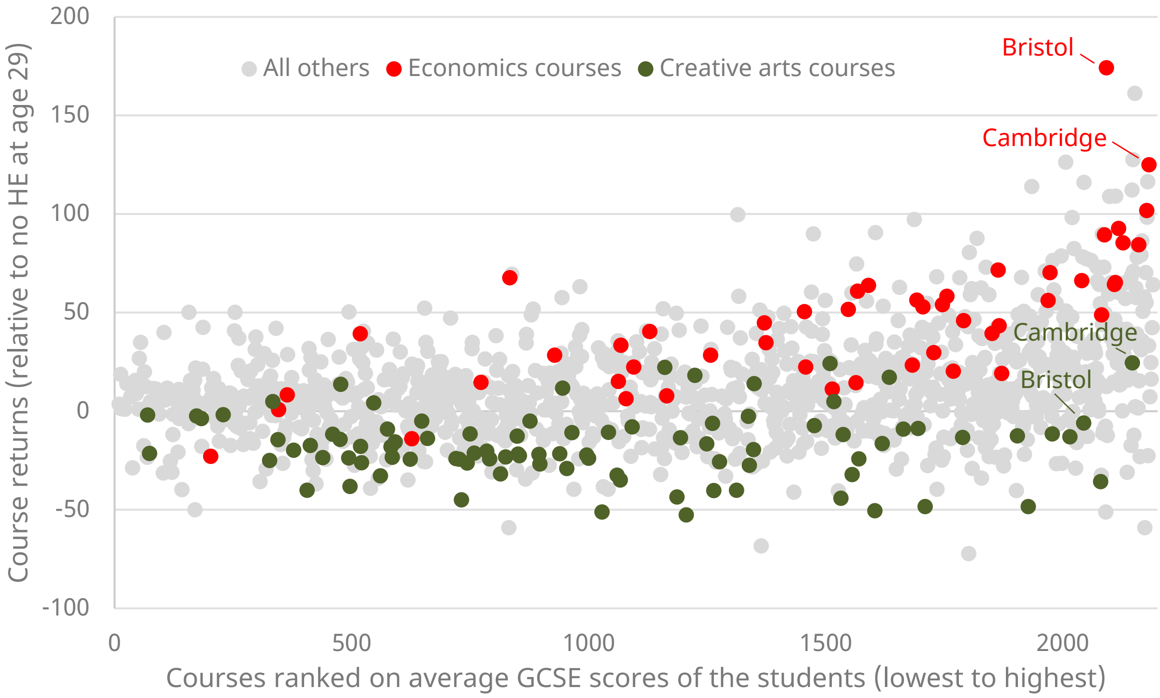
Among high-earning graduates, this arguably constitutes an unfairness between those who did and did not take up a loan: those privileged enough to have wealthy parents from whom they can borrow contribute less to the government's finances than those who don't. Beyond this unfairness that only affects high earners, this issue creates a communication problem for the government: it is not actually true that taking out a loan is a good deal for *all* prospective students. This would be different if interest rates were more closely aligned with the government's cost of borrowing.

An additional point worth raising is that, in theory, high interest rates on student loans also create the wrong incentives for prospective students. They would incentivise students to pursue shorter degrees and discourage switching degrees midway through so as to avoid high interest rates during study. They would encourage career choices that promote short-term over long-term earnings, as high student loan repayments at the start of a career reduce interest charges later.

[10] See link

Furthermore, they could affect university choices of many students. Even though only the highest-earning graduates will ever repay their student loans, and hence these are the only students for whom the interest rates charged directly matter, it may affect a wider set of students if they take into account the probability they *may* become high earners and hence be affected by these interest rates. This could then affect the subject choice of those with high prior attainment, as subject choice can matter a great deal in determining future earnings for this group. This point is highlighted in Figure 9, which draws on previous IFS research which has estimated the earnings returns to different "courses" (i.e., subject-institution combinations) relative to not going to university at age 29.[11] Along the horizontal axis, courses are sorted by the average GCSE scores of their students, with the most selective courses over to the right. While economics can yield extremely high returns at the most selective institutions, the same is not true for all courses – in particular, the figure highlights that the returns by age 29 are quite low for some of the most selective creative arts courses.

Figure 9: Course returns for men by average GCSE scores



Note: Shows returns for men only. Estimates taken directly from Belfield et al. (2018) "The impact of undergraduate degrees on early-career earnings".

Source: LEO data (NPD-HESA-HMRC).

6.4 Lowering of repayment threshold and increase in repayment term

In order to maintain revenue neutrality, the Augar Review also proposed to increase the repayment term to 40 years and lower the repayment threshold to £23,000. The first of these changes primarily leads to an increase in repayments later in life for those who would not have repaid their loans after 30 years. The second change raises repayments for those earning more than £23,000 in any given year. However, the

[11] As highlighted in Belfield et al (2019), there are several caveats to these estimates. See link for more details.

lifetime repayments of those who would fully repay their loans within 30 years even under the higher threshold will be largely unaffected. Both of these changes would largely raise repayments for graduates in the middle of the graduate earnings distribution.[12]

7. Other Proposals

Besides the reform packages proposed by Labour and the Augar Review, a number of other reforms have recently been proposed. The **Brexit Party** has promised to axe interest rates on student loans altogether. Under this plan, the RAB charge, which measures the proportion of student loans the government expects to write off, would rise to 66%. For the government, this would cost about £3.5bn per cohort of students, increasing the government contribution to HE by more than 40%.

The beneficiaries would be middle and high-earning graduates, with the highest-earning graduates benefitting the most. Lower earning graduates would not benefit at all, as even with interest rates at 0% most of them would never pay off their loans. For the 2020 cohort, lifetime graduate repayments would fall by around £14,000 on average, but by more than £40,000 for the top 10% of graduate earners.

The **Liberal Democrats** have proposed a £10,000 “adult education grant” which would improve funding for older learners to re-train. Under the scheme, the government would deposit money in a so called “skills wallet” that individuals could access to fund approved education or training courses. For each individual, the government would deposit £4,000 in the skills wallet at age 25, £3,000 at 40 and another £3,000 at 55.

This is similar in spirit to Labour’s “six-years free” adult education policy but substantially less generous and flexible. Like Labour’s policy, the cost of this adult education grant is impossible to assess precisely, but given the £10,000 limit, it seems likely that the annual cost would be in the low billions or high hundreds of millions. Similar to Labour’s proposal, both the cost and the risk of fraud will crucially depend on what kinds of courses will be eligible and how tightly the system will be regulated. It is worth noting that Individual Learning Accounts, a similar (but much less generous) scheme introduced by the Labour government in 2000, had to be scrapped completely in 2001 as a result of widespread fraud.[13]

The **Green Party’s** policy on higher education funding is similar to Labour’s: they also want to scrap fees and reintroduce maintenance grants. However, in contrast to Labour, the Green party explicitly advocates the cancellation of *all* outstanding student debt, including maintenance loans, loans for those who studied before 2012, and postgraduate loans. In the long term, this would add around £70 billion to the national debt.

8. Summary

Higher education funding has been subject to near-constant reform over the past 20 years and more seems likely to come. Many reform proposals have been criticised as “regressive”, in that they benefit the highest earning graduates the most, but this should

[12] For more details on the distributional effects of the individual components of the Augar proposals, see our Observation from June: link.

[13] Details can be found in this report by the National Audit Office.

not be the focus of attention: the student loan system's primary purpose cannot be the redistribution of income. Through the tax and benefit system the government has other more effective tools at its disposal to achieve this. Attention should instead focus on whether reforms reduce the complexity of the system and get the incentives right for students and universities.

The proposals put forward in the Augar Review would improve the incentives for universities to provide more courses that are expensive to teach and improve incentives for students with the highest earnings potential to choose courses that will maximise their earnings. However, the Augar package would *increase* complexity by adding yet more tweaks to the repayment terms on student loans.

Labour's policy would dramatically reduce the complexity of the system, but it would not provide a clear improvement in terms of incentives. On the one hand, a switch to grant funding would allow money to be re-allocated towards priority subjects, improving incentives for universities; on the other, uncontrolled growth in student numbers could result in expansion in a way that is not socially optimal.

Finally, it is notable that the proposals from the Augar Review, the Labour Party and the Liberal Democrats all look to support adult education more generally rather than only standard undergraduate degrees for full-time students. This is a welcome and overdue change.